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ACTIVITIES OF THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS AND ITS JOINT UNITS

Experience gained in technical cooperation activities involving assistance in formulating negotiation strategies

Report of the Secretary-General

SUMMARY

The present report provides an analysis of some of the major lessons that have been learned by the United Nations Centre on Transnational Corporations through its technical cooperation programme about trends discerned in strategies adopted by developing countries in negotiating with transnational corporations. The report focuses on two aspects that are always of major concern to developing countries - the sharing of financial benefits derived from the transnational corporations' investment projects and the relationship between transnational corporations' activities and national development policy goals; highlights the growing importance attached to environmental concerns in the negotiating process; and emphasizes the need of developing countries for technical assistance in their formulation of negotiating strategies.

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INTRODUCTION

1. At its seventeenth session, the Commission on Transnational Corporations requested the United Nations Centre on Transnational Corporations to submit a report on the experience gained by the Centre in implementing its technical cooperation programme. The present report responds to that request.

2. So as to define the kind of relationship they wish to promote in their dealings with transnational corporations, developing countries have had to focus on and constantly review three broad areas of interaction: (a) general policy, (b) the legislative framework and (c) investment project negotiations. With regard to policy and the legislative framework, it is now well recognized that the past few years have witnessed a significant change in the attitude of developing countries towards transnational corporations. Various reports have documented the increasing liberalization of the policies and legislative framework of developing countries in their bid to attract more foreign direct investment through transnational corporations. The report of the Secretary-General to the Commission at its sixteenth session on experience gained in technical cooperation activities with respect to the formulation and implementation of foreign investment policies (E/C.10/1990/14, para. 8) gave emphasis to this trend:

> "This change in attitude towards transnational corporations is reflected in official investment policies and in the legislative treatment of transnational corporations by many developing countries in Latin America, Africa and Asia, as well as by certain Eastern European countries. Liberalization has occurred both in those countries that have traditionally been host to transnational corporations and in certain economies that were previously closed to foreign capital. In general, developing country Governments are promoting foreign investment more aggressively than at any time in the past. There is a distinct shift away from rigid regulation and towards policies that are flexible and innovative."

3. It needs to be kept in mind, however, that a host country's liberalization of policies, laws and procedures for dealing with transnational corporations and attracting foreign investment may not materialize in increased inflows of investment if the negotiation strategies adopted by government officials with regard to specific investment projects create disincentives for the potential investors. Furthermore, whatever such inflows may be, the actual benefits gained and the costs incurred therefrom will depend primarily on the negotiation strategy employed by the host developing country in relation to each individual investment project. Thus, an understanding of the effect on developing countries of the recent liberalization of policy and laws affecting foreign investment calls for an examination of whether changes in attitudes of host developing countries towards transnational corporations, as reflected in policy and law, have been translated into the negotiation process.

4. The present report seeks to analyse some of the major lessons that have been learned by the Centre through its technical cooperation programme about the trends discerned in strategies adopted by developing countries in negotiating with transnational corporations. It should be noted from the outset that while the Centre's technical cooperation programme in practice covers a wide variety of sectors, the analysis in this report covers mainly the natural resources sector. The rationale for such an emphasis is that since transnational corporations are in most cases the primary suppliers not only of investment capital but also of know-how, technology and market access, the involvement of those corporations in the natural resources sector is particularly substantial. Furthermore, a large share of requests by developing countries for the Centre's technical assistance is related to that sector. Nevertheless, the present report highlights the essential dimensions of contractual relations involving transnational corporations in all sectors, and it will be evident that both the issues involved and the technical assistance needs of developing countries are in many respects common to all sectors of a developing country's economy.

I. DIFFERENT STRATEGIES FOR THE SAME OBJECTIVES

5. It is the view of many observers of relationships between developing countries and transnational corporations that the era of confrontations has ended. However, a review of the factors that lay behind the confrontations shows that the two basic objectives that developing countries were attempting to achieve then are still very much a part of their strategies today when they enter into contractual relationships with transnational corporations. The first basic objective is, of course, to obtain a fair share of the fiscal take from any particular project; the second is to further certain national development policy goals such as transfer of technology, employment generation, training of nationals, export growth, domestic value added, use of domestic raw materials and forward and backward linkages. Whatever the emphasis or orientation of a particular developing country regarding stated national development policy goals, a basic objective of all such countries is to ensure that transnational corporations' activities in their territories are carried out in a manner that furthers those goals.

6. While these two basic objectives remain as important as they were in the past, what is now new are the different strategies employed by developing countries to achieve the same objectives. What is also relatively new is the prioritization in contractual negotiations of an important policy issue: the requirement that transnational corporations take account of environmental concerns.

A. Fair share of project revenues

7. While a wide range of topics may be covered in any investment project negotiation between a developing country Government and a transnational corporation, the core of any agreement resulting therefrom will be the

division of the project revenues between Government and investor. In the case of developing countries the determination of such a division acquires a special context, especially for projects inherently of long duration. Developing countries want to ensure that the division of revenues remains fair throughout the life of the project. Investors, on the other hand, want to avoid open-ended arrangements in which host countries can, as circumstances may require, alter the types and rates of taxes. The issue then is how to satisfy the legitimate concerns of both parties.

8. Generally speaking, industrialized countries will always provide incentives for attracting foreign investment, on the understanding that they still retain the right to make tax changes as circumstances may require. Although there are some developing countries in a relatively strong bargaining position that can also keep intact their right to make such tax changes, most developing countries cannot attract large-scale investment on the basis of an open-ended fiscal regime. Such investment, if it has a long payback period, is likely to mean that the investing transnational corporation will require contractual guarantees - the so-called fiscal stability clauses - over the life of the project with regard to the applicable fiscal regime.

9. Despite conscious attempts to make their business climate more attractive to foreign investors, many developing countries are still dogged by certain negative but not necessarily correct perceptions of potential foreign investors regarding the stability of their investment regimes. Unfortunately, this situation has in some cases been complicated by political instability, which undermines a coherent and predictable policy environment. Although foreign investors are on average influenced more by economic determinants than by political risk considerations, there is evidence that some investors consider political instability a major disincentive to investment in certain countries or regions (see E/C.10/1990/9, para. 30). Thus for transnational corporations taking what they perceive to be a risk by investing in such an environment, the fiscal stability clauses requirement reflects a cautious approach that they regard as reasonable in the circumstances. The element of caution aside, transnational corporations sometimes argue that even if they were willing to forgo fiscal stability clauses, without the cash flow guaranteed by securing specific undertakings from the host developing country, they still could not raise from their bankers the large capital necessary to finance major projects.

10. While fiscal stability clauses may seem a reasonable requirement to transnational corporations, they can create dilemmas for developing countries. For a long-term project, the Government of a developing country finds itself in the unenviable position of having to accurately assess the yield to be expected from an investment proposal by making predictions of prices and costs 5, 10 or even 20 years ahead. Yet, given the information and technological database available to many of those countries, such an assessment is, in most cases, rather than mere guesswork, at best a gamble.

11. In the case of mining and petroleum projects, Governments are effectively asked to determine the price at which they are prepared to sell their natural resources at a time (prior to exploration) when they usually have no clear idea of the size or quality of the deposit in question. In fact, that situation exemplifies an aspect of bargaining power of which transnational corporations are all too aware. To wait until a commercial discovery has been made before seeking agreement on the fiscal regime would mean loss of the leverage that, prior to exploration, comes from those corporations' assumption of the risk involved.

12. Governments faced with these dilemmas are all too aware of the many cases where, for example, a mine or oil field turned out to be much larger or much more profitable than had originally been anticipated when an agreement with a transnational corporation was signed. The hue and cry thereafter was that those who had negotiated the agreement sold out the country (and included the not-too-infrequent accusation that corruption must have been involved).

13. Such experiences have left many developing countries with the belief that provision for renegotiation should be an essential feature of any satisfactory agreement. While some transnational corporations view the concept of renegotiation as anathema to contractual stability, most of them recognize the validity of the basic reasoning that changing circumstances can indeed turn an agreement into a lopsided arrangement for either party.

14. The necessity of reviewing contracts that have been affected by fundamental changes is recognized in many legal systems, particularly in developed countries. For example, the French doctrine of imprévision and the German doctrine of Wegfall der Geschöftsgrundlage provide for the revision of contracts, in appropriate cases, by reference to objective criteria not traceable to the will of the parties. Indeed, many transnational corporations, whether pursuant to a renegotiation clause or not, frequently request from Governments relief from fixed charges such as royalties and customs duties during times of financial constraint.

15. Developing countries, on the other hand, are keen to enshrine renegotiation clauses in contracts so as to avoid future accusations of attempted expropriation. However, the willingness of transnational corporations to accept renegotiation clauses is usually predicated on the understanding that in the contract appropriate language will be used to eliminate the possibility of either party employing a review clause to implement unilateral changes to that contract. The problem for developing countries is that unless such clauses are very precisely worded situations frequently occur where fundamental changes in economic conditions require some contractual adjustment for the benefit of the developing country but agreement cannot be reached on the kind or level of adjustment required to respond to the changed conditions. Furthermore, even with a renegotiation clause, the constant adjustment and readjustment of contract terms that would be necessary to keep pace with constantly changing economic conditions cannot be fully accomplished under the infrequent periodic reviews afforded by the majority of such clauses. Such shortcomings with respect to these clauses has therefore

meant that some other form of augmentation is necessary for developing countries to fulfil the desired objective.

16. Developing countries have therefore expressed interest in receiving assistance from the United Nations Centre on Transnational Corporations in the negotiation of fiscal regimes that are flexible enough to adjust within the terms of the contract itself to a wide range of economic variables. There are many ways in which such flexibility can be achieved. For example, it may be achieved by using, in the determination of profit shares, a formula based on the relationship between cumulative net cash flows and cumulative capital expenditure. In some other cases, a royalty may be adjustable in relation to a certain factor, such as the price obtained for a mineral. In still other cases physical criteria may be more appropriate; in the oil industry, for example, a variable royalty related to an index of well productivity may be used.

17. In addition to sensitizing the fiscal regime to different economic variables, an important objective of developing countries is to ensure their taking a large share of any excess profit bonanzas, particularly in the case of natural resources. A minimum price at which a given resource can be produced consists of production costs plus some profit level that is sufficient to make the investment attractive. The extra value over and above this minimum price, usually referred to as the economic rent or resource rent, can be viewed as the value of the resource itself which belongs to the community at large. Therefore, once a company has earned a profit that is sufficient to induce it to invest, it should be possible for the host country to take a large part of that extra profit or rent without deterring the investment. This is usually done by applying what is commonly referred to as a resource rent tax or an additional profits tax. 1/ Such a tax is paid only after a certain negotiated threshold rate of return has been earned, and so is charged only on profits that have been earned in addition to the threshold return. The point at which the rate of return has been earned is calculated by compounding (at a rate equal to the threshold rate of return) the project's annual net cash flow for each year in which the compounded net cash was negative and by continuing to do so for as long as the total of that compounded cash flow remains negative.

18. Many of the transnational corporations that accept that upside bonanzas above a reasonable rate of return should be shared with the Government emphasize a parallel need on the downside: providing the investor with fiscal relief under less profitable circumstances even if such a course results in a reduction of the government take. In the spirit of pragmatism evident today, many developing countries have no problem in dealing with this particular concern. 2/

19. In structuring all such fiscal regimes, the aim is to create a flexible tax structure that will, within the ambit of the contract or agreement, also result in a larger share going to the Government if the profitability of the project exceeds expectations. The experience of the Centre has been that transnational corporations are not averse to such a possibility and that many

of them have had the experience in one country or another of operating under a fiscal regime that imposed excess profit taxes. A few are of course reluctant to forgo the prospect of an upside bonanza and in fact view it as a necessary incentive for investment.

20. The imposition of excess profits taxes is common in developed countries. For example, in 1991 the Congress of the United States of America passed a law called the Excess Oil Profits Tax Act of 1991, which imposes a tax of 40 per cent on the excess net profits of large oil companies. The aim was to capture possible excess profits made as a result of oil price increases caused by the Gulf crisis. Under this law, excess net profits constitute excess net income for the taxable year over average annual net income for the period of five taxable years immediately preceding the taxable year in question. Developed countries can easily impose such taxes by legislation when and as appropriate. Most developing countries, however, find that if they are to attract investment, before the start of any pfoject they have to negotiate objective criteria for determining when those taxes can be imposed so as to ensure that no part of the fiscal regime is left open ended.

21. The difficulty, then, for developing countries is to devise the appropriate structure and choose the ideal device from the array of complicated formulas that have been developed around the world. Also a difficult issue is determining a reasonable rate of return for a transnational corporation so as to decide the threshold at which excess profits taxes should be applied. Furthermore, structuring an appropriate fiscal regime of the nature under discussion involves the use of certain economic assumptions in a manner that requires both access to up-to-date economic data and availability of financial analysts able to design the required computer-based models. Yet those data and analysts are frequently in short supply in developing countries although in abundance for transnational corporations. The Centre has endeavoured through its technical assistance programme to fill the gaps.

22. The recent renegotiation of a mining agreement between one African country and a mining company that is a wholly owned subsidiary of a publicly quoted United States transnational corporation provides an example of the use of such technical assistance as is provided by the Centre. The Government of the country in question was seeking modifications to contractual terms last agreed with the company in 1975 and was in particular dissatisfied with the way in which the agreement had been dealing with the allocation of revenues.

23. The Government requested technical assistance from the Centre. In the course of a Centre review of the negotiating positions, it became clear that the Government had been to a large extent working in the dark and that an effective negotiating strategy required a much more detailed knowledge of a whole range of financial matters affecting the future profitability of the project than that with which the government negotiating team was then equipped. The positions taken by the Government appeared reasonable but could not be properly assessed or defended without obtaining the economic data needed for a computer-based fiscal analysis of the project. In the light of that consideration, the Centre advised the Government that further analytical

work should be done to determine the company's financial position and predict the Government's take from the project on a range of possible economic assumptions. On the basis of the relevant financial information, the Centre designed a computer model of the mine. The model enabled the Government, with the assistance of the Centre's experts, to estimate the out-turn of the fiscal regime on various alternative assumptions and was therefore an essential tool in bargaining sessions with the company.

24. The fiscal regime agreed between the Government and the company was complex and no attempt to provide a comprehensive analysis will be made here. However, the main elements included (a) mining lease rent and surface rent, (b) an adjusting royalty, (c) an income tax and (d) an additional profits tax. The additional profits tax in particular was designed to respond to the desire of the Government to have a meaningful share of any especially large profits that might accrue should mineral prices rise very sharply.

25. Despite misgivings about long-term commitments, the trend seems to be that most developing countries are willing to provide the necessary contractual undertakings for fiscal stability. In providing contractual undertakings aimed at ensuring that no significant part of the fiscal regime remains open-ended, there are, however, two matters that developing-country Governments insist transnational corporations must keep in mind. First, the undertakings must be in a form consistent with the host country's legal and constitutional requirements. Thus, for example, in countries whose constitutions enshrine parliamentary sovereignty, the Government cannot give binding commitments that would imply that parliament cannot in future adjust or raise taxes. 3/ Secondly, contractual undertakings for stability should not extend beyond the specifics of the fiscal package. Developing-country Governments are not willing to take the position that if, for example, future legislation on social or environmental issues results in an increase in business costs, any particular investor should be exempted from making its contribution to the cost of general development while the other members of society carry this burden. 4/

B. Compliance with national development policy goals

26. The capacity to formulate and ensure the promotion of national development policy objectives is of fundamental importance to any Government. In this respect, developing countries have sometimes viewed transnational corporations as a threat. Such corporations are seen as having the ability, through the control of strategic or key sectors of the economy, to affect, in one way or the other, the Government's development objectives and to have an impact that may be contrary to government policy. For many developing countries, equity participation was seen as the avenue for ensuring that transnational corporations behaved in conformity with government objectives. Because Governments of those countries assumed that through such participation they would gain an effective say in managerial decisions. This view was one of the primary catalysts to the partial or full nationalization of transnational corporation investments and also one of the reasons for barring or restricting new foreign investments in terms of specified shareholding percentages.

27. Over the past decade, developing countries have made extensive policy changes in the areas relating to entry and ownership requirements. Those countries recognize that acquiring part ownership in ventures with transnational corporations does not guarantee a say in all of the decision-making process. The experience of countries that have taken an interest in many mining or petroleum projects shows that the investor will require a veto over important policy decisions and that some basic management prerogatives must remain intact. In fact, transnational corporations may effectively control an operation without even holding majority ownership because of their access to foreign markets and the relevant technology. Besides (except in the natural resources sector, where a number of agreements provide for "free equity" for the Government), many developing countries have gone through painful lessons of being burdened by heavy commercial debts acquired for the purpose of buying equity in ventures from which they have in the end realized no benefits commensurate with the debt they now carry.

28. The recognition by developing countries that equity participation is not a must for achieving their objectives has affected their attitudes not just to future investments. Today, a number of developing countries are in the process of generally redefining the role of the State in the economy. Indeed, many are moving in the direction of becoming more facilitators and regulators of productive activities and less direct producers and suppliers of goods and services. To this end, Governments are engaged in the sale of State-owned companies to the private sector and are prescribing that State-owned companies should subcontract to private companies an increasing share of activities related to the production and supply of goods and services. Due to a number of factors, including the unavailability of a well-developed private entrepreneurial class and the weakness of the local capital markets, privatization programmes in developing countries have significant involvement of foreign transnational corporations. The Centre is therefore increasingly called upon to assist Governments in negotiating the relevant terms, including in a number of cases debt equity swaps.

29. Despite the disappointments from equity participation, developing countries still seek to regulate the activities of transnational corporations to ensure that such activities are consistent with national development goals. Governments are therefore shifting from entry and ownership restrictions to the prescription or negotiation of performance targets and their effective monitoring. In assisting developing countries to formulate legislation or negotiate contracts, the Centre has often demonstrated that where there is a proper regulatory scheme embodied in legislation or a contractual agreement, any additional leverage resulting from equity participation is likely to be of only marginal importance and that if effectively monitored, such schemes can provide the adequate control required. Over time, most developing countries have come to the conclusion that equity participation is not necessarily an effective means of achieving control.

30. A legislative scheme of the kind mentioned above was recently formulated, with the assistance of the Centre, by one East African country for its mining sector. Among other things, the legislation will:

(a) Give the Government, through the issue and renewal of prospecting or exploration licences, regulation of the exploration programme by establishing work programmes and minimum expenditure requirements;

(b) Ensure, through the operation of the licensing system and mandatory area relinquishment provisions, a measure of control over the pace of exploration;

(c) Secure for the Government, through reporting requirements imposed on licensees, a flow of accounting and financial data, as well as of geological and geophysical data;

(d) Secure for the Government, at the time when a commercial deposit has been identified, a substantial measure of decision-making power over mining operations, through the requirement of submission of a development plan containing proposals for development and mining and its approval by the Government;

(e) Maintain a continuing measure of regulatory powers during the course of mining operations, through the implementation of the proposals for development and the need for government approval before any major changes can be made in those proposals.

31. The same kind of detailed level of regulatory control can also be achieved under the contractual arrangement itself. Many petroleum or mining agreements specify that the foreign investor will submit to the Government proposals for the construction, establishment and operation of petroleum exploitation or mining facilities, covering specific matters set out in the agreement. The agreement then establishes a procedure for the Government's approval of the proposals submitted and for the resolution of any differences that might arise in connection with them. Once the proposals are approved, the investor is bound by contract to carry out the project, substantially in accordance with the approved proposals. Variation in the approved proposals would require further approval from the Government under a procedure established in the agreement.

32. Regulatory schemes of the kind described above are sometimes criticized by transnational corporations as creating the possibility of imposing unnecessary managerial rigidity on their projects. Those corporations complain that if anticipated circumstances subsequently change, the whole project may be put in jeopardy by the difficulty of reaching agreement with the Government on an appropriate modification of the proposals originally agreed. While most of this criticism is not justified (as evidenced by the fact that very few projects in developing countries have actually aborted as a result of failure to reach agreement on an appropriate development plan), it nevertheless reflects the reasons why developing countries in their bid to be attractive to foreign investors sometimes have difficulties in determining the extent of the regulation they should impose. This is thus an issue on which the Centre is frequently called upon to provide advice.

33. In providing assistance to developing countries formulating sector-related legislation the Centre has observed those countries practising two contrasting styles. Some countries have taken the course of enacting highly comprehensive laws that, in either the law itself or regulations made under it, provide in detail for a great many of the issues that arise in the course of operations carried out by the investor in a particular sector. At the other end of the scale are some statutory schemes that are no more than a loose framework, leaving most of the detailed questions to be regulated by the terms and conditions set out in licences or agreements. Advantages and disadvantages are connected with either course of action.

34. The most significant advantage of enacting a detailed regulatory scheme is that in terms of the Government's own choosing it limits the scope of the matters that have to be covered in negotiations between the Government and the foreign investors. Most transnational corporations, if they are faced with legislation that has been carefully drafted with due regard to established practices in a particular industry, will take the law as they find it. Some provisions may be regarded as unnecessary or irksome but because they are in the law they will be accepted. Similar provisions if they appeared in a model agreement or a government draft put forward in negotiations at large, could result in prolonged, time-wasting discussion.

35. By the same token, however, the enactment of a detailed legislative scheme introduces for both sides an element of inflexibility. Unless the requirements imposed on investors are somewhat minimal, there is in practice a danger that standards will be set at a level that could, in particular cases, act as a serious disincentive to investment. A developing country wishing to attract investment to a particular sector must set terms that correctly reflect the country's current standing in the market. In practice, however, it is not always easy to set such terms (unless the developing country is in an unusually strong bargaining position) without first testing and probing the basic elements of a deal in properly conducted negotiations. 5/

36. The Centre has encountered situations where Governments have little choice in the short term but to rely upon contracts rather than detailed legislation. Such cases arise especially in newly opened economies where the absence of private investment activity has resulted in the fossilization of core commercial legislation and of the relevant sectoral legislation to the degree that that legislation has to be extensively supplemented by contractual provisions covering what would otherwise be taken for granted under modern legislation. Such contracts will contain, for example, not just rates of income tax but detailed rules for the computation of taxable income. The same situation arises in a number of developing countries where commercial legislation is virtually unchanged from colonial times. There are even cases in former centrally planned economies where such legislation has been abolished altogether.

37. In such cases Governments have had to proceed with comprehensive contracts rather than await the elaboration of fully fledged legislation. The Centre has assisted such Governments in drafting model contracts that enable a

degree of consistency in their approach to be established from the start. However, the Centre advises such Governments that ultimately, when investment interest accelerates, the contract-by-contract approach will not be sustainable administratively. It becomes evident that workable general legislation is necessary, and unless the Government has strong reasons for retaining scope for bargaining over general issues such bargaining is increasingly restricted to project-specific matters.

38. Flexibility and the capacity to adjust quickly to a perception of market forces are the most significant advantages of regulating transnational corporations' operations with a law that provides only a framework (to be amplified in matters of detail by the publication of a model agreement), but the extent to which model licences or model agreements have to be adapted in the course of negotiations will very much depend on the bargaining strength of the country concerned. The petroleum sector provides good examples of these considerations. The model licences set out in the Petroleum Production Regulations of the United Kingdom of Great Britain and Northern Ireland can by law be modified by the Secretary of State but in actual fact modifications take place rarely and only in very special circumstances. That the model clauses set out in the Regulations are therefore indistinguishable in practical terms from a statutory provision set out in a law or in delegated legislation is a reflection of the strong bargaining position of the United Kingdom in dealing with oil companies. For most developing countries, with a much weaker bargaining position, the situation is somewhat different. In publishing a model agreement or a model licence, a developing country must generally anticipate (unless it has a well-established petroleum sector) that modifications - and sometimes substantial ones - may be necessary before agreement can be reached with private sector oil companies on a major investment in exploration.

39. Because of the uncertainty of developing countries being able to sustain a policy framework set out in a model agreement or licence, the Centre has advised a number of them to compromise by adopting what might be described as a mixed or hybrid system. Within that system certain basic provisions are set out in a law of general application that stipulates the minimum terms and conditions that must be satisfied by applicants for the grant of exploitation rights. At the same time the system allows for key matters to be settled in agreements. Matters dealt with in an agreement would generally include minimum work and expenditure obligations, some elements in the fiscal regime that will determine the final division of profits generated by the project and the methodology for dispute settlement.

40. Whatever form or method a Government chooses for providing the regulatory framework for transnational corporations, an important factor that has to be kept in mind is the ability to monitor compliance with such obligations as may be prescribed. In their attempts to formulate the most effective contractual provisions, many developing countries have unfortunately sometimes ended up with contractual arrangements that constitute an administrative nightmare for the officials involved in their monitoring and compliance.

41. In one example, the Centre recently advised a Government involved in a protracted foreign exchange dispute with one of the country's principal foreign investors concerning the issue of the investor's adherence to contractual foreign exchange arrangements over a lengthy investment recovery period. The dispute had been unresolved for several years and entailed a very substantial sum. One of the major problems was that the underlying conctractual conception had led to a set of rules far too complex to administer properly within a rapidly changing economic climate.

42. A discussion paper prepared by the Centre for a meeting dealing with the petroleum sector in Asia and the Pacific 6/ put the problem of the complexities of monitoring in the following terms:

> "The ability to administer petroleum agreements is often an issue that does not receive the proper attention it deserves. In many cases, new laws, regulations or contracts are introduced on the assumption that administrative capabilities will somehow be developed in the future. But more often than not, this does not turn out to be the case. There is a need therefore to make concerted efforts to bring about a better balance between administrative capabilities and the complexity of petroleum arrangements."

43. Not too infrequently, however, lapses in monitoring efforts occur that are not a result of complex arrangements. In providing technical assistance to developing countries, the Centre's experts have come across situations where difficulties arose as a result of Governments not exercising their contractual rights of monitoring compliance on an ongoing basis. Instead, those Governments dusted off and analysed the relevant contracts only in the event of significant infringements of the obligations of transnational corporations. In one recent case of contract renegotiation with a transnational corporation, one of the issues about which the Government in question was dissatisfied was its inability to have more access to the decision-making process regarding the transnational corporation's activities. Interestingly, however, under the provisions of the agreement that was being renegotiated, the Government had had for some years the right to appoint two directors to the board but had not in fact done so. Following inquiries by the Centre, it turned out that government authorities had actually not been aware of having that right - a clear example of the case where contractual provisions may prove to be ineffective only for lack of monitoring or enforcement.

C. Prioritization of concern for the environment

44. Until quite recently, an assessment by developing countries of the impact of activities of transnational corporations on the natural environment took a secondary if not marginal role in project planning. For many of the developed country-based transnational corporations seeking to realize the cost advantages of relatively less demanding environmental standards in developing countries, maintaining those lower standards was a deliberate objective in the

negotiations of contractual commitments. The situation was exacerbated in some developing countries by Governments that, in making a drive towards attracting foreign investment in an increasingly competitive climate, found themselves confronted with the difficult choice between approving environmentally substandard projects that could provide badly needed financial benefits for their countries and rejecting such benefits because of the long-term socio-economic costs. Many Governments chose the former course.

45. However, the recent world-wide focus of attention on environmental issues, as well as the tragic experiences of some developing countries arising out of environmental disasters caused by transnational corporations' activities and subsequent difficulties in allocating liability and costs, has pushed environment management and protection to the forefront of project planning. While developing countries' policies are now oriented towards taking into account factors related to the environment, problems still remain on how to formulate, in relation to individual projects, the necessary contractual stipulations.

46. In dealing with transnational corporations, the environmental policy expectations of the host country may be expressed in the country's legislation, in a particular investment project contract between the country and the transnational corporation or in both legislation and a contract.

47. Many developing countries do not have legislation specifically targeted on environmental protection. However, most of those countries do utilize provisions in sector-oriented legislation for the purpose of setting environmental goals with reference to the particular sector. Although such provisions do not prescribe precise standards of environmental quality to be attained, they do set the basic criteria that must be translated into environmental protection measures during the actual negotiation and formulation of investment project proposals. Such an approach has certain advantages. For developing countries that have not yet formulated a comprehensive policy on environmental issues, using contracts to stipulate specific environmental provisions offers an opportunity to set environmental standards that are adapted to the technical and ecological particularities of each investment project without the need to go through cumbersome legislative procedures.

48. However, the approach of simply providing general criteria in sectoral legislation can also be disadvantageous to a developing country. The Centre's experience with these criteria indicates that there can be a wide range for discretion in their application, which may result in the defeat of the intentions of the legislature that formulated them. The translation of general legislative provisions into practical decisions in the course of contract negotiation may require an element of bargaining about issues that should otherwise not be debatable.

49. The negotiation of mining or petroleum agreements has a special dimension that affects the content of environmental provisions included in the contract. It is important from the point of view of both parties that the

content and scope of the provisions dealing with environment be tailored to the needs of the individual mine or petroleum field under consideration; but if negotiations are carried out prior to exploration, such individualized adaptation must remain incomplete since much of the required data are not yet available at that stage. Thus, in most of the recent agreements entered into between developing countries and transnational corporations, the investor is required, on making a discovery, to supplement the mining or petroleum development plan with a comprehensive environmental impact study. For the host country, such open contractual stipulations have the advantage of postponing the specification of environmental requirements until a clear, accurate assessment of information needs can be made. For the investor, however, such regulation may pose the disadvantage of setting no definite limits to the costs of development.

50. Aside from the uncertainty about costs, an even more worrisome problem (from the point of view of the investor who has spent huge sums of money at the exploration stage) is the possibility that investor and host country, taking into account the results of the environmental impact study, may fail to reach agreement on whether the investor's development proposals are environmentally sound or not.

51. In anticipation of possible failure to reach agreement on environmental protection measures, some Governments insist that agreements expressly draw environmental criteria into the approval process for the project. In such cases, the minister responsible may make known to the investor certain objections to the investor's plans or designs relating to the project, with the Government's reserving the right to withhold its approval of plans and designs that may unreasonably damage the surrounding environment, limit its further development potential or significantly disrupt socio-political stability in the area. Provision is usually made to ensure that such approval shall not be unreasonably withheld or delayed.

52. Setting environmental standards without providing adequate enforcement procedures could be a wasted effort. Various forms of enforcement provisions relating to the environment are therefore now becoming a standard feature of agreements negotiated between transnational corporations and developing countries. Such provisions mainly consist of environmental reporting requirements and government inspection rights.

53. The monitoring of the environmental effects of operations of transnational corporations must of course be complemented by the provision of sufficient coercive means to ensure adherence to set standards. The problem is that coercive measures prescribed under the legislation of most host developing countries generally provide protection only in cases where the natural environment or the resource in question is significantly endangered. Thus in negotiating individual contracts, developing countries now seek to provide for additional measures that will allow their enforcement authorities to ensure ongoing compliance with the prescribed environmental standards. In particular, such provisions empower government authorities to carry out necessary remedial and protection measures at the expense of the investor. 7/

Provision may also be made for the investor to furnish a security deposit that can be used by the host country to fund the remedial and protection measures undertaken by the government authorities.

II. CONTEXT OF THE ASSISTANCE PROVIDED BY THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS IN CONTRACTUAL NEGOTIATIONS

54. It could be assumed that the now-perceived demise of the era of confrontation between developing countries and transnational corporations might imply a drastic reduction in contentious issues and a corresponding lessening need on the part of developing countries for technical assistance in their contractual negotiations with transnational corporations. The Centre's experience indicates, however, that the reverse is true. The new pragmatism exhibited by developing countries in dealing with transnational corporations has certainly been an eye-opener for those corporations with respect to the previously unused or underutilized options (of the kind described in this report) that developing countries can employ in their attempts to protect their interests while attracting foreign investment. However, while developing countries are willing (at the policy level at least) to put to maximum use development of the wide range of different schemes that offer alternatives for achieving their objectives, they are still keenly aware that if their government officials involved in specific negotiations are to take full advantage of those schemes - with a proper understanding of their financial, legal and technical implications - complementary outside expertise remains extremely important. The Centre's technical assistance programme has felt a high demand for such expertise and continues to feel it.

55. It should be noted that with regard to any specific negotiation between a developing country and a transnational corporation for which technical assistance is provided, the Centre's role is to advise and assist the Government. The Centre avoids, of course, any possibility of being viewed or even portrayed as a party to the negotiations and thus neither takes positions of its own in those negotiations, nor seeks to act as a mediator. Characteristically the Centre's experts work with a team of government negotiators under the leadership of a senior government official. Thus, the contractual arrangement that results from any such negotiation will reflect the particular country's own orientation and attitude towards transnational corporations and foreign investment.

56. In the course of providing assistance to Governments, the Centre of course sometimes encounters the well-known rivalries between different government departments and the promotion of self-interest by each of them, especially in countries where State-owned enterprises are involved in or have a monopoly over the relevant sector. In such cases, a particular department may propose, for example, that most of the revenues to be derived from a particular project be received in the form of royalties (to be collected by that department), while the income tax department would prefer to collect those revenues as income tax. Although the Centre does not act as arbiter to

such disputes, the independent opinion provided by the Centre usually gives a considerable measure of comfort to the decision makers when they finally have to make their choices.

III. CONCLUSIONS

57. The analysis in this report of some of the negotiating strategies now adopted by developing countries indicates that new forms of contractual relationships have emerged that have an inbuilt element of fiscal regime durability and can meet compliance and monitoring requirements of developing countries without such countries imposing on themselves unnecessary financial burdens related to acquisition of equity. Concern for the environment has also been shown to be an increasing priority for developing countries in the formulation of contractual relationships with transnational corporations. Against this background, the necessity of having continuous access to up-to-date information and data on legal, economic, financial and fiscal matters, in order to structure an appropriate contractual framework, has been emphasized. The importance of having available relevant expertise for the design of fiscal regimes and the evaluation of alternative proposals made during the course of negotiations has also been pointed out. Yet, it is in these areas that developing countries still face serious limitations. Efforts by the international community to provide assistance should therefore remain a priority if the pragmatism exhibited by developing countries in adopting innovative measures is to bear fruitful results. In that regard, the technical assistance programme of the United Nations Centre on Transnational Corporations has been adapting continually to respond to the changing needs and priorities of developing countries.

Notes

1/ For a detailed exposition of the concept, see Ross Garnaut and Clunies Ross, Taxation of Mineral Rents (Oxford, Clarendon Press, 1983) and Christopher Goss, Petroleum and Mining Taxation: Handbook on a Method for Equitable Sharing of Profits and Risk (London, Royal Institute of International Affairs, 1986).

2/ Legislation in many developing countries provides for the remission of royalties in such circumstances. See, for example, the Uganda Petroleum (Exploration and Production) Act (1985), sect. 48.

3/ However, the agreement may provide that where such tax increase adversely affects the investor, (a) other parts of the fiscal regime will be adjusted in order to ensure that there is no effective change for the investor or (b) that increase will be paid by a State entity on behalf of the investor.

Notes (continued)

4/ Where a transnational corporation is concerned that such social legislation may be used to target it for payment of all such costs, especially in a poor or small country with a single large foreign investment project, contractual guarantees may be provided to ensure that that legislation will not be discriminative.

5/ One West African country has requested the Centre's technical assistance in drafting a new mining law based on that country's experience in recent negotations with three mining companies.

6/ United Nations Centre on Transnational Corporations/United Nations Development Programme Asia-Pacific Round Table on Fiscal and Administrative Strategies for Petroleum Exploration and Development, held in Kuala Lumpur, Malaysia, from 16 to 18 September 1991.

7/ See clause 10 (k) of the Sierra Leone-Sierra Rutile Agreement, 1989.

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ACTIVITIES OF THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS AND ITS JOINT UNITS

Information requirements for assessing the performance of corporate obligations

Report of the Secretary-General

SUMMARY

The present report examines two main issues related to the follow-up of agreements concluded between Governments or local enterprises and transnational corporations: (1) the need to establish reporting systems that allow performance to be tracked and (2) the usefulness of frameworks that allow for comparability of information to ensure transparency and accountability of operations across borders. The report first discusses uses of information and some of the factors making the availability of and access to information on companies and performance of increasing importance, particularly to market-driven economies. The report then identifies and discusses the kinds of information that need to be disclosed and how such information can be collected, analysed and used by Governments or local enterprises. It then examines existing international accounting standards and efforts being made for multilateral cooperation. Finally, the report discusses some action that could be taken with regard to national and international frameworks.

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INTRODUCTION

1. At its seventeenth session, the Commission on Transnational Corporations requested the Secretary-General to report to it at its eighteenth session on the experience gained in the development of the comprehensive information system of the United Nations Centre on Transnational Corporations. 1/ The present report discusses the information required to track the performance of transnational corporations. Governments and other parties concerned follow the operations of companies within their jurisdictions, including transnational corporations, both to ensure compliance with laws and regulations and to safeguard their interests as shareholders in joint ventures.

2. Earlier reports on the comprehensive information system focused on the information sources necessary to meet the needs of developing countries when making decisions prior to the involvement of transnational corporations in their economy. These reports have been expanded and are included in the recently published Transnational Business Information: A Manual of Needs and Sources. 2/ The Manual deals with policy objectives of information, preparing for negotiations, identifying priority industries, selecting company candidates, finding in-depth information on companies and negotiating with them.

3. The theme of the present report is the information requirements for the next phase: what are the information needs after the conclusion of negotiations leading to the establishment of a joint venture or a foreign subsidiary in the host country? Access to appropriate, adequate and timely information is as essential to the follow-up phase as it is during the negotiation and decision-making phases to ensure that such benefits as transfer of technology, employment and training, preference for local goods and services, and foreign exchange are realized. This theme is discussed in the broader context of the collection, analysis and dissemination of information about business enterprises in general: what are the sources of such information? How can the information be reported? How can it be used?

4. Section I contains an introductory discussion of the uses of information to track company performance and of the factors that make information access increasingly important. Section II identifies the kind of information that needs to be disclosed for different purposes. These include evaluating the financial state of companies, assessing the development benefits of their activities, monitoring the environmental impact and evaluating the effectiveness of operations. Section III moves from "what" to "how", namely, how the information identified in Section II is reported, the national and international mechanisms in place to specify reporting requirements and the interplay of those mechanisms. In particular, it discusses the existing mechanisms for the definition of international accounting standards, and the reporting systems established at the local level through legislation or contractual requirements. Section IV discusses the organization and flow of information in meeting the needs of the users. It touches upon the costs and benefits of establishing information collection and analysis systems and discusses the sharing of information within and between countries, the locus

of responsibility for data collection and analysis, coordination, and the role of local representatives on the boards of directors of joint ventures. Section V contains an assessment of the state of development of performance tracking systems and recommendations on possible improvements.

I. THE INTERNATIONAL CONTEXT OF INFORMATION REQUIREMENTS

5. There is a wide consensus that information availability is a key requirement for the efficient and effective functioning of a market economy. There are numerous users of, and needs for, information. The users include present and potential investors, employees, lenders, suppliers and other creditors, customers, government bodies and the public. Their needs for financial and other business information are varied. For example, investors interested in a return on their investment need information to determine the profitability of the enterprise; as shareholders they need information to assess the ability of the enterprise to pay dividends. Lenders are interested in information to determine whether their loans and the interest thereon will be paid on time. The public, affected by the impact of enterprises on the local economy, may need information on the range of activities of those enterprises and their prosperity.

6. Governments require information to regulate business activities, to set taxation policies, to determine compliance with laws, regulations and contractual provisions and to protect investors. Further, they and their agencies may be investors in enterprises, partners in joint ventures, lenders, guarantors or suppliers and customers. In that capacity, they have the same information needs as non-governmental users. The position of Governments and local partners in joint ventures is an example. A large share of investments in developing countries is in the resource sectors, such as petroleum, mining, forestry and fishing. As the Government is often the owner or steward of the resources, it is frequently a participant in joint ventures. Similar arrangements are common in other sectors, where Governments make land or infrastructure available as part of their contribution to a joint venture. In such circumstances, they are in the position of shareholders in addition to their position as regulators and collectors of taxes. A Government as a shareholder requires the same information as any other shareholder in order to assess the profitability of its investment.

7. Financial transparency and accountability are essential to allow all users - public or private - to make informed economic decisions. Freely accessible information promotes trust and cooperation in business dealings. Conversely, friction may arise when local parties and transnational corporations lack the information required for decision-making. The issue, then, is how to make information available in an efficient fashion in the complex world of overlapping jurisdictions and transnational economic activities.

8. Western industrialized countries have long recognized the importance of information access and have set in place far-reaching information disclosure

and analysis systems. The more developed the economy and the more market oriented it is, the more information is collected and required to be publicly disclosed. Information is crucial, for example, to the operation of a public securities market. Almost all stock exchanges have their own reporting requirements for listed companies, in addition to the reporting requirements of the national legislation. The requirements are very detailed. For example, the compensation of the three highest paid officials of a company, including fringe benefits and pension, must be disclosed in accordance with the rules of the Securities and Exchange Commission of the United States of America.

9. There are gaps in the information made available. One of the major problems in obtaining information about a transnational corporation is the very "transnationality" of the corporation. Since it operates across the borders of countries, it is extremely difficult if not impossible for any one country to obtain all the necessary information to track a company's performance for both monitoring and investment (market) purposes. Consolidated financial statements of transnational corporations contain information on parent and subsidiaries but usually that information is not segmented by line of business or geographical area and cannot be extracted to permit the identification of items in financial statements that pertain to a specific country. Developed market economies have recognized the existence of such problems and are beginning to address them. For example, as a consequence of the recent BCCI (Bank of Credit and Commerce International) and Maxwell cases, the United Kingdom of Great Britain and Northern Ireland and the United States of America, countries with highly sophisticated reporting requirements, are re-evaluating the adequacy of their information collection and analysis systems and moving towards more stringent requirements.

10. Transnational corporations of developed countries are among the most knowledgeable and intensive users of the information available, which gives them competitive advantage. Not all developing country Governments and local enterprises, on the other hand, have the capability to assemble the information necessary for sound business dealings, have access to sources of information and data or have in place the information infrastructure necessary to track company performance. In some cases, the cost of collecting information in the required degree of detail appears prohibitive.

11. The Commission on Transnational Corporations has recognized the imbalance in access to information between developing countries and transnational corporations. As developing countries move increasingly towards market economies, this imbalance becomes more critical in regard not only to the relationship between transnational corporations and developing countries but also to the participation of developing countries in market-driven economic systems. It is in the areas of information gathering, management and exchange, in particular, that developing countries are seen to be at a disadvantage. There has been considerable international effort, which is likely to be required for some time to come, to assist developing countries to develop their information infrastructure.

II. INFORMATION REQUIREMENTS

12. There are a number of needs and purposes with respect to accessing company information, which vary from user to user. To establish an effective tracking system, a country must identify its information needs and the purposes to be served by the system. The sections below discuss information required for financial, developmental and environmental purposes and for assessing operations.

A. Financial information

13. Local parties require both macro- and micro-economic information. Macroeconomic information is necessary to understand basic economic trends so that government policies can respond to existing circumstances; micro-economic information must be obtained to determine and allocate revenue.

14. Central banks, such as Federal Reserve Bank of the United States and the Bank of England, are among the institutions that collect and analyse macroeconomic information. At this level, Governments need to keep track of foreign exchange flows. This requires that foreign currency transactions and all loans and debts of subsidiaries be reported. In this connection, the central bank will usually keep track of foreign exchange remittances for the purchase of goods and services abroad, the payment of interest and other financial charges, as well as the repayment of principal under loan agreements and the repatriation of dividends. The extent to which projects are foreign exchange earners (or losers) needs to be appreciated by the central bank and ministry of finance authorities, and that information shared with the other ministries concerned. Keeping a tally of the extent to which Governments provide loan guarantees for transnational corporation projects, either directly or indirectly, is another macroeconomic issue which requires more attention by Governments. What is called for is a mechanism or reporting procedure to keep track of guarantees and to provide for an appreciation of the extent of the financial exposure.

15. A company's revenues and expenses are typical examples of information at the micro-economic level. This information must be obtained in order to assess a company's income taxes, a basic governmental function, and as the basis for national income statistics. The basic micro-economic information that permits a company's performance in the financial area to be tracked is contained in its annual balance sheet, profit and loss statement, and cash flow statement or statement of sources and application of funds. In addition, in the case of joint venture operations, the Government, as a shareholder, should have access to additional financial information in order to compare performance with revenue forecasts and cost limitations established in annual budgets. This is discussed further in section D below, covering information required to track operations. Information requirements in this area are very detailed in developed countries; less so in developing countries. Harmonization of requirements would lead to raising standards of information access.

16. Transfer pricing is an issue of prime importance for the tax administration authorities as well as for those dealing with customs, exchange controls and restrictive business practices. "Transfer price" is the term used to describe the price charged for the purchase or sale of goods or services between related entities within a transnational corporation family or group of related companies. In order to avoid distortions, the price charged should be a fair market or arm's length price. Governments and local participants, however, are concerned that a company might charge more or less than a fair market price for such intra-group transactions by under- or over-invoicing. This is usually called "transfer pricing abuse", though in practice the word "abuse" is frequently dropped so that "transfer pricing" has a negative connotation.

17. The most common reason for transfer pricing abuses is to manipulate profit between national jurisdictions with tax rate differentials in order to minimize the taxes paid by the transnational group as a whole. Transfer pricing may be increased by a transnational corporation because of royalties, import and export duties and other fiscal charges or impositions payable on the basis of the price paid or received. On the other hand, it could be reduced if the corporation was able to collect fees for trademarks, patents and know-how and services such as management, marketing and technical assistance.

18. In countries that have exchange controls, transfer pricing is used to avoid exchange control regulations and to reduce exchange risks by exporting at lower than fair market prices (or importing at higher), particularly where artificial exchange rates exist and where currency devaluations (or revaluations) can be expected. In times of political uncertainty, transfer pricing devices are frequently used to place money in jurisdictions that are perceived to be safe havens.

19. The amount of government revenue that can be lost by reason of transfer pricing abuses can be highly significant. This was estimated at 29 per cent for American transnational corporations in 1985 and over 30 per cent for Japanese transnational corporations in 1983. 3/ It can readily be seen that just a 10 per cent manipulation of price would have a significant effect on taxable income and import and export duties. It would have a similar effect on the net profits shared with local partners in joint ventures. Transfer pricing abuses also limit the profits available for distribution as dividends.

20. Many developing countries do not have the administrative capability to monitor transfer pricing transactions. Through the Centre's advisory services, tax authorities from Canada, the United Kingdom and the United States have assisted developing countries to set up such mechanisms. The Centre has advised a number of Governments in establishing legislation to protect revenue and control transfer pricing. More recently, the Centre has focused on transfer pricing in joint venture agreements and suggested a number of transfer pricing protective provisions which could be used in joint venture contracts. One of the clauses suggested would require a joint venture partner to report on a regular basis each transaction or series of related

transactions with an affiliated company above a significant threshold amount. Transactions below that amount would be reported in the aggregate. 4/ In the Centre's experience, efficient information gathering and analysis mechanisms in this area have the potential of yielding significant benefits for Member States.

B. Information on the development impact

21. A host country party, upon entering into a foreign investment agreement or a joint venture agreement, expects a positive impact on its own economic and social development from the project operation in its territory. Purchase of local goods and services, employment and training of citizens and transfer of technology are some of the ways in which the operation of a transnational corporation can have a positive impact on local conditions. Such an impact can be as important as financial gains for many developing countries. Accordingly, contractual arrangements or foreign investment regimes spell out requirements to undertake certain actions or to achieve certain specified outcomes. In the Centre's experience, contractual development requirements are seldom coupled with information disclosure which would make the provisions effective.

22. There are various kinds of information that can be used to determine whether expected outcomes have in fact been achieved. For example, year-end reports on the amounts of goods and services purchased locally will help to track the implementation of local preference provisions. Reports on employment and training will provide evidence of compliance with arrangements concerning the localization of management and technical skills. To track technology transfer, a Government or local partner may want to confirm that the relevant manuals are delivered, personnel are trained, advice is given on innovation, and improved patents are shared within a specified time-frame.

23. Some companies voluntarily submit to the host country partners value-added statements to document their contribution to local development. A typical value-added statement reports on the amounts paid directly to the Government, including income taxes, import duties, export duties or sales taxes, pay-as-you-earn payments for employees, rentals for the use of national land or facilities and payments to the Government or local utilities for power, water, transport and so forth. Such statements also show payments to local employees by way of salaries and bonuses, as well as vacation payments, medical aid and other benefits. Value-added statements also report payments locally by way of dividends to local investors (government, parastatal or private) and interest paid to local financial institutions. Some statements further report the amounts paid for community development, including charitable contributions, educational contributions, and monies spent locally for community assistance, including construction of facilities such as schools, the provision of local transportation, or making infrastructure available to the public. Value-added statements help local partners to appreciate some aspects of the contribution of transnational corporations, but they complement rather than substitute for the instruments of monitoring.

C. Information on the environmental impact

24. Today, most Governments recognize the importance of protecting the environment and preventing and controlling pollution. Monitoring is essential for the conservation and management of the environment, especially because this is one area in which any deviation from standards has to be detected as early as possible to prevent irreparable damage. Information that is crucial to protecting the environment is difficult and expensive to obtain. Establishing environmental base lines against which to assess the effect of a proposed activity can be a time-consuming and expensive process, even for the most developed countries.

25. Many developing countries do not yet have the basic environmental legislation in place to establish standards and monitoring systems. The Centre has been active in advising countries in the preparation of such legislation. Until legislation is in place and administered, it may be necessary for these countries to protect their environment by including in contractual arrangements specific provisions to that end.

26. Such contractual requirements usually include a mandatory environmental impact study or statement. This entails the projection and assessment of the impact on the environment of a proposed activity, not only the impact on human health, safety and welfare, as well as on air, water, land, animals and the entire ecological system, but frequently on the aesthetic and socio-cultural values of the community as well. Environmental impact statements serve as the tool for assessing the immediate, short-term and long-term effects on the environment of the proposed activity, for weighing the economic costs and benefits and other advantages and disadvantages of a proposed project and for considering alternatives.

27. Contractual requirements could also include an environmental management plan to provide for the equipment and procedures to measure and monitor the environment, to prevent significant adverse effects, to take any necessary action to ameliorate or mitigate them and, finally, to provide for restoration, reclamation and rehabilitation.

28. The information collected through the environmental impact statements could be disclosed for the benefit of other investors and host parties to enable them to deal effectively with the different problems that need to be addressed in preparing environmental management plans. Pooling of information through greater disclosure and sharing can contribute to more effective cooperation in environmental protection.

29. Compliance with environmental protection requirements could be documented and tracked through, for example, special purpose reports included in annual reports of a company's board of directors and the accompanying financial statements. Information gathering and analysis for environmental protection is an area in which developments in the definition of standards, disclosure requirements and the establishment of international cooperation and coordination mechanisms could provide great benefits to the international community.

D. Information on operations

30. While annual financial information provides a view of the overall financial health of the company, operational information, when properly collected and analysed, provides an indication of how efficiently the company is performing, as well as the profitability of specific operations of the company. It is also useful when tackling the problems raised by transfer pricing practices.

31. In almost every business sector there are certain key ratios of general applicability that are indicators of management performance. In the hotel sector, for example, the occupancy rate (the percentage of available rooms actually rented), room rental revenue as a percentage of total sales, the average daily room rental rate and the cost of food and beverages as a percentage of food and beverages sold are some of the key indicators. When local parties as shareholders are interested in tracking the efficiency and profitability of specific operations, they must first be aware of these indicators and then make appropriate arrangements to obtain the necessary information in usable form. In the Centre's experience, many agreements contain financial reporting requirements, but few contain requirements for the reporting of management information in sufficient detail to permit timely evaluation of performance.

32. Most transnational corporations require that their managers submit detailed monthly management reports to the head office, which are usually based on an annual operating line item budget - that is, a projection of the expected costs and revenues for the year, broken down into detailed items (the "line items"). The monthly management report then indicates for each line item the actual result for the period compared with the budget and, usually, compared with the prior year. This is frequently summarized on a year-to-date basis so as to even out the fluctuations that may occur in any particular month. Any result that is significantly different from the budget projection is usually explained by the manager in a short summary statement at the beginning of the report. In this era of computerization, monthly management reports can usually be prepared with minimum expenditure. They are crucial to the understanding of the workings of any business activity of any size. There is a trend for copies of the monthly management reports to be required. This, of course, should be done in such a way that the confidentiality of commercially sensitive information is protected.

33. In addition to monthly management reports, most companies prepare quarterly financial reports that are not audited. Copies of these reports may be obtained so that problems can be identified early, and so that it is not necessary to wait until the end of the financial year, when the annual audited financial statements are prepared, in order to appraise the financial aspects of operations. These quarterly and annual financial statements (balance sheet, profit and loss statements and cash flow reports), when prepared on a standard format, as required for example by the Fourth Directive of the European Community, 5/ will facilitate the comparison of operations. The advantage of this approach is that it affords host parties access to information that is already compiled, without imposing an added burden on the company.

III REPORTING REQUIREMENTS

34. The previous section discussed the major purposes for which information is required to track compliance with contractual obligations. The existing national and international frameworks for information disclosure are discussed below.

A. International accounting standards

35. Four different groups have been formulating international accounting standards since the 1970s. They have created a well-developed body of voluntary standards without enforcement mechanisms (so-called soft law) which, if implemented, could lead to increased transparency and comparability in financial statements. The groups share several characteristics. Three are intergovernmental and public: the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, a subsidiary body of the Commission on Transnational Corporations, the Contact Group of the 15th Directorate of the European Community (EC) and the Working Party on Accounting of the Organisation for Economic Cooperation and Development (OECD). The International Accounting Standards Committee (IASC) is composed of experts from the private sector, namely the accounting profession. Two groups (the Intergovernmental Working Group and IASC) are international and two (the OECD and EC groups) are regional. The Intergovernmental Working Group, which has 34 members, comprises developing countries and countries in transition in addition to developed countries. The members of the other three groups are almost exclusively from the developed countries. Only the standards developed by EC are enacted into national legislation and so have the force of law.

36. Despite the fact that four different bodies have been involved in this exercise, their standards are internally consistent with each other and have done much to promote the objective of the harmonization of national accounting standards. However, in some cases they permit alternative treatments, which limits comparability. Consequently, there is a move under way to eliminate those options. As they stand, they represent a solid framework which can serve any country that wants to establish an accounting and reporting framework. In fact, a number of developing countries and countries in transition have found it more appropriate to adopt them rather than another country's standards. International accounting standards are increasingly being used because of the globalization of business, with enterprises looking beyond their own borders for opportunities to raise capital. In the near future, the members of the International Organization of Securities Commissions (IOSCO) may require that enterprises listed on their exchanges use international accounting standards.

37. The United Nations Centre on Transnational Corporations gives technical assistance in this area. Its standards are found in two publications, Objectives and Concepts Underlying Financial Statements, 6/ and Conclusions on Accounting and Reporting by Transnational Corporations. 7/ More recent

pronouncements are found in International Accounting and Reporting Issues: 1989 Review 8/ and 1990 Review. 9/ The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting regularly discusses such unresolved issues as the best practice for accounting for intangible assets or environmental protection measures or how to deal with the problems arising from privatization. In addition, it has initiated a programme of technical cooperation in Africa and in countries in transition to help them with various aspects of accountancy development. In particular, experts members of the Group have participated in a task force in one region to revise that region's accounting rules and standard-setting process.

B. National frameworks

38. Many countries have recognized the need to set up comprehensive frameworks for business information disclosure, as this is seen as beneficial to economic activity. Access to understandable, relevant, reliable, comparable and timely information facilitates evaluating company performance and making sound economic decisions. The leading countries in the collection and analysis of information are those with the largest market economies, for example, the United States, Germany and France. An analysis of the requirements of leading and emerging industrialized countries shows that they are extensive but similar in many respects.

39. Many industrialized countries require that reports be filed annually (and sometimes more frequently) by companies under their company law, commercial laws or securities legislation. In particular, they have comprehensive information and reporting requirements for public companies. Such records enter the public domain after a specified period. For example, the reporting requirements of the United States Securities and Exchange Commission (see para. 8 above) are particularly extensive and generally regarded as well thought out, and can serve as an effective model for other Governments.

40. Reporting requirements are usually found in legislation and regulations. Governments set out in detailed regulations the information that is to be reported, how frequently, in what form and for what time periods. The objective is to ensure that the information required is specific and obtained in a consistent form so as to permit comparison and analysis. This requires that the same categories of information be disclosed for each reporting period and that the same types of information be disclosed for projects within the same industry.

41. In areas where the importance of monitoring has recently emerged, more can be done in defining reporting requirements. Environmental protection is one such area. The Intergovernmental Working Group on International Standards of Accounting and Reporting has undertaken a review of environmental laws and regulations in various countries regarding information disclosure on environmental matters. It found that, despite the heightened awareness of some transnational corporations, consideration of environmental issues was not widespread in their annual reports. There was also an absence of accounting

regulations, which allowed the enterprises wide latitude in what they reported. The information given on environmental protection measures was largely descriptive and often contained no more than corporate policies or intentions. Based on its surveys of best industry practices in 1989 and 1990 and its discussions, the Group formulated recommendations for improved environmental accounting and reporting. The items recommended for inclusion in the annual report and the financial statements include (a) the formal policy and programmes adopted by the enterprise with respect to environmental protection measures, (b) environmental emission targets and (c) the financial or operational effect of environmental protection measures on the capital expenditures and earnings of the enterprise. 10/

42. In the absence of legislation, reporting provisions have often been included in contractual arrangements. This is viewed, however, as a stopgap device pending the preparation of appropriate legislation. It is obvious that the vagaries of ad hoc negotiations do not allow Governments to enforce uniformity in the reporting process, and may not result in the establishment of uniform standards of information and disclosure requirements. There is a growing recognition of the need for adequate reporting requirements, especially in the chemical, pharmaceutical and forestry industries. There is, in fact, a trend to require more detailed reports to permit tracking compliance with provisions in those areas.

43. Pending the establishment of national systems, local parties could access information publicly disclosed in home countries. Reliance on existing sources permits local parties to take informed decisions without adding to the reporting obligations of transnational corporations. In the Centre's experience, this information source is not used as frequently as it might be. While recent cases in the international banking industry have demonstrated the difficulties that any one country may encounter in obtaining information on the entire operations of a company, few local parties attempt to acquire information on transnational corporations that is readily available in other countries and useful for comparison purposes. It might be simple to provide in agreements, particularly joint venture agreements, that a transnational corporation submit to a host country copies of the public reports which it makes available to countries in which it operates.

44. The Centre has assisted developing countries in gaining access to that information by making available not only its extensive collections of the annual reports and stock exchange filings of public companies worldwide, but also of national reporting requirements. The Centre has supplemented the reports with financial analysis and has provided training in defining appropriate reporting requirements.

IV. USING INFORMATION

45. Information is of itself of limited usefulness. Raw data must be processed and analysed to become serviceable. There are cases in which information is available, but needs to be more actively used before benefits can be derived from it. Specific information requirements, coupled with an

adequate review mechanism, permit local partners to confirm that the requirements of contractual provisions and relevant legislation have been met. Countries need to evaluate the costs and benefits of establishing a business information reporting and analysis system. Among the costs are the tangible cost of establishing and managing the system and the intangible one of discouraging a potential investor, should the reporting requirements be perceived as unduly burdensome. Among the obvious benefits is the likelihood of increased revenue and ability to take appropriate (profitable) business decisions. The section below discusses some of the issues that a country faces in setting up an information analysis system to monitor business activity.

A. Sharing of information

46. Countries have different ministries, agencies and institutions collecting information, each for their own purposes. Thus, the ministry of mines may be interested in production statistics; the department of the environment collects information on pollution, erosion, restoration and the like; the central bank, on foreign currency transactions; the ministry of finance, on taxable income; customs and excise, on import and export statistics.

47. The information necessary to track the performance of a transnational corporation is frequently dispersed within a country and information concerning activities outside its borders is always difficult to obtain. Frequently, the host parties in joint ventures do not have internal arrangements for the sharing of information given to local directors with the ministries that have the technical ability, experience and capacity to analyse the information. Further, agencies may be reluctant, for confidentiality or other reasons, to share the information they have, so that seldom is information exchanged inside a Government with any greater frequency than between Governments. Lack of information and the absence of arrangements to share it may prevent local parties from realizing the benefits they are entitled to under contractual arrangements or legislation. Countries need to evaluate the pros and cons of information sharing and strike the balance between information sharing and confidentiality that is most appropriate to local conditions.

B. Locus of responsibility

48. Countries have often found it useful to designate a lead agency for the collection and analysis of monitoring information. A national development corporation or a particular line ministry or statistical office could be designated for that purpose. The Government of an Asian country has organized a government shareholders agency to oversee its joint venture interests. When a Government owns hotels, the natural focal point would be a national hotel corporation; in the petroleum sector, it would be the state petroleum corporation. Ideally, all the categories of information discussed previously under information requirements ought to be accessible to the monitoring authority.

C. Coordination

49. Procedures and guidelines need to be established to spell out how the information is to be analysed and evaluated, what financial and other standards need to be adopted and how the data are to be obtained and measured. Those standards require coordination among the line ministries that have the necessary expertise to do the analysis and evaluation, as well as, in the case of joint ventures, with the Government's representatives on boards of directors. Some Governments have found it useful to have regularly scheduled meetings of appropriate officials to evaluate the performance of companies in which a Government is a joint venture participant. A coordination agency is essential for those purposes.

D. Role of local representatives on the board of directors

50. The role to be played by locally appointed members on the board of directors needs to be fully gauged. All too frequently countries do not have the internal arrangements for information sharing between the local director and the ministries with the capacity and expertise to analyse the information so that the monitoring function is left with the local representatives on the board of directors. While, in principle, directors have access to all information disclosed under the relevant company laws, all too often the information is not sufficient and does not reach the directors in time to obtain feedback from the competent ministries. Further, not all directors are aware of all their rights and responsibilities.

51. The Government of one developing country, concerned that its directors representing local partner interests on joint venture boards were not fully aware of their rights or of their duties and liabilities, has requested that the United Nations Centre on Transnational Corporations conduct a training programme for government and locally appointed directors. In this connection, the Centre is contemplating the preparation of a manual or handbook which would set out the basic information including rights, duties, liabilities, procedures and guidelines for the benefit of company directors in discharging their functions to represent a local party's interests on such boards.

E. International information exchange

52. Information exchange across national borders is an emerging issue. The very transnationality of transnational corporations and the fact that there is hardly any single authority, national or international, having an accurate picture of their entire operations across multiple borders, contributes to the clouding of transparency and accountability. In recent cases, particularly in the publishing and banking industries, transnationality has been used to ensure opacity and to evade the supervisory functions of Governments, which of necessity are restricted to their jurisdictions. The events suggest that the international framework for information disclosure and exchange may not have been used effectively and that there are gaps in international information exchange.

53. As a result, many countries, including Germany, the United Kingdom and the United States, are currently considering regulatory changes and bilateral and multilateral arrangements for the sharing of information. In the banking and securities industries, these include clarification of the country, or perhaps an international, mechanism designated as regulatory base with which consolidated information is filed; sharing of information between and among authorities; international information sharing and conformity with minimum managerial, financial and operational standards. These tools are necessary for each host country to protect its citizens and its national interests. Tax authorities of some OECD countries have discussed methods of cooperating more closely to deal with tax avoidance through the manipulation of transfer prices. There appears to be a trend towards greater international information sharing to permit the monitoring of critical sectors. Countries need to assess this issue in the design of information collection and analysis systems.

V. CONCLUSIONS

54. The preceding discussion leads to some conclusions on information and reporting requirements for tracking company performance. While much is being done to set up effective information reporting and monitoring mechanisms, there is still room for substantial improvement. The major conclusion that emerges, however, is that much of the information currently reported is not well utilized.

55. In addition, in the area dealing with transnationality, a substantial amount of work has yet to be done in implementing and extending uniform international accounting and reporting standards. This is a problem with which even the developed countries have not satisfactorily come to grips. Developing countries suffer even more from this problem. International action to address the issue appears to be desirable.

56. Governments may consider taking the following action for the purpose of, on one hand, making existing information better accessible within and among countries, and, on the other, obtaining from transnational corporations the information required for effective performance tracking:

(a) Review their existing legislation to ensure that it is sufficient to obtain adequate information to track the activities of the companies they deal with, so as to ensure the transparency of operations and promote accountability. Guidelines should address locus of responsibility, information sharing, feedback, confidentiality and standardization:

> Few investment regimes currently include information disclosure guidelines sufficient to meet international needs;

(b) Review their administrative practices to obtain and consolidate information from their own reporting systems:

Many of the problems with tracking performance stem not so much from lack of information per se, but from failure to put the right information into the right hands at the right time. A structured review of procedures can illuminate shortcomings and point out needed modifications to existing procedures;

(c) Introduce standardized reporting procedures and forms and adopt uniform accounting standards:

Insufficient standardization limits the comparability of the information obtained;

(d) Ensure that the information collected is shared, analysed and made accessible in usable form:

Even where information reporting requirements are set out, there may be practical obstacles to information flow, such as the unwillingness of some departments to share information useful for tracking company activities, or lack of awareness of large information resources that exist within or outside the national territory, such as company filings to home country authorities;

(e) Promote intergovernmental cooperation for the exchange of information with other Governments on a regular basis:

While substantial work has been done to develop international reporting standards, much remains to be done for the international sharing of information across borders.

57. The Centre has assisted national and international efforts to improve the flow of information to track business activities. In the further development of this function it could prepare manuals on information needs and reporting requirements; assist and advise in locating sources of necessary information; analyse the information flows in developing countries and advise on their improvement; conduct seminars and workshops for officials and local directors of joint venture companies and other contractual/legal entities; and assist in the development of reporting standards and mechanisms for the international exchange of information.

Notes

1/ Official Records of the Economic and Social Council, 1991, Supplement No. 10 (E/1991/31), para. 149.

2/ United Nations publication, Sales No. 91.II.A.13.

3/ See Transnational Corporations in World Development: Trends and Prospects (United Nations publication, Sales No. 88.II.A.7), table VI.1.

Notes (continued)

4/ Details of these provisions are included in "Transfer pricing protective provisions in joint venture contracts", paper prepared for the International Workshop on Negotiating Joint Ventures Agreements, Moscow, 19-23 March 1990.

5/ European Communities, Council Directive No. 78/660/EEC, 25 July 1978.

6/ United Nations publication, Sales No. 89.II.A.18.

7/ United Nations publication, Sales No. 88.II.A.18.

8/ United Nations publication, Sales No. 90.II.A.4.

9/ United Nations publication, Sales No. 91.II.A.3.

10/ See the report of the Secretary-General on accounting for environmental protection measures (E/C.10/AC.3/1991/5).